**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C. 20554**

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| **In the Matter of** | ) | |
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| **BellSouth Telecommunications, Inc.** | ) | **WC Docket No. 02-304** |
| **Tariff FCC No. 1, Transmittal No. 657** | ) | |

# AT&T CORP.
# OPPOSITION TO DIRECT CASE


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October 24, 2002

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Pursuant to the Investigation Order ("*Investigation Order*") in this matter released on September 18, 2002, by the Chief of the Pricing Policy Division, AT&T Corp. ("AT&T") hereby submits its Opposition to the Direct Case filed by BellSouth Telecommunications, Inc. ("BellSouth") on October 10, 2002 ("Direct Case").

## I. INTRODUCTION AND SUMMARY

This proceeding is the first investigation of a series of anticompetitive proposals by incumbent LECs designed to leverage the recent bankruptcy filings of several competitive local and long distance carriers to gain regulatory approval for radical new tariff provisions that the incumbents would use to disadvantage the remaining carriers that have sound credit and that pose no exceptional bad debt risk. BellSouth's professed justification – which it never supports and is entirely unfounded – is that the changes brought on by the Telecommunications Act of 1996 have created a "high risk, highly volatile" industry that has substantially increased BellSouth's exposure to uncollectible bad debts for interstate access services. BellSouth's direct case does not come close to establishing a need for any such tariff revisions.

Given the grossly excessive returns that BellSouth and other large incumbent LECs achieve on access services, BellSouth's plea for additional security is simply thinly disguised greed – and a stark effort to gain an anticompetitive weapon to use against its new long distance rivals. In 2001, for example, a period in which BellSouth claims that its bad debt uncollectibles rose significantly, BellSouth earned about a 21 percent rate of return on interstate access and just under *50 percent* on special access services. Given the hefty margins on services for which BellSouth continues to enjoy near-monopolies, there is no need for the Commission to take additional steps to help BellSouth maximize its access revenues.

In fact, BellSouth's proposals are an incredibly overbroad response to a largely nonexistent problem, and they should be promptly rejected. No aspect of BellSouth's provision of access services is particularly risky or volatile, and, as demonstrated below and in the accompanying declarations, BellSouth continues to enjoy very low *actual* levels of bad debt expenses that are in no way indicative of any long term bad debt crisis that is beyond the capabilities of BellSouth's existing tariff provisions.

In this regard, BellSouth has grossly exaggerated its claims that the recent downturn in the market has exposed it to substantial liability from unpaid access bills. The ARMIS data reported by BellSouth's bad debt expense remain generally less than one percent and never higher than 1.5 percent. The recent fluctuations in BellSouth's uncollectibles are modest and consistent with prior variations, and simply result from normal fluctuations in the business cycle or from other short-term market conditions.

In these circumstances, the Commission's price cap system already accounts fully for these potential uncollectibles expenses. Under the price cap system, any year-to-year fluctuations to bad debt expense are considered business risks that the LEC must absorb (just as BellSouth retains the benefit of lower than average bad debt levels during periods of economic strength). Moreover, the Commission's existing prescribed tariff language already fully protects BellSouth from customers with a proven history of non-payment, and from customers without established credit. BellSouth fails to explain why these provisions, which were in place in prior economic downturns, are no longer sufficient.

The *Investigation Order* recognized these and other problems with BellSouth's tariff revisions, and weeks ago placed BellSouth on notice that its direct case should include numerous categories of specified data and should address nearly all of the concerns outlined above. But BellSouth's direct case ignores many of these requests, and fails to address a number of the *Investigation Order's* core concerns. In these circumstances, the only proper inference to draw is that such information, if produced, would be harmful to BellSouth's case.

Furthermore, even if BellSouth had come forward with the requested data, including data that demonstrated some limited increase in its exposure that is not already appropriately covered by the Commission's price cap rules or by its longstanding tariff prescriptions relating to non-payment risks, BellSouth's proposed tariff revisions are by no means a narrowly circumscribed and measured response to any such problem. BellSouth seeks virtually unfettered discretion to demand security deposits from its access customers based upon "credit scores" generated by proprietary credit scoring tools that, by their very design, can be manipulated to produce virtually any result – and, indeed, to demand security deposits even from customers that "*pass*" the arbitrary hurdles BellSouth would set. For large IXCs, the amounts demanded as "security" deposits could be hundreds of millions of dollars – easily enough to disrupt the business plans of even large carriers that are otherwise able to pay their bills.

As the *Investigation Order* (¶ 15) explicitly questioned, the anticompetitive effects of such a system are alarming. BellSouth has already disclosed that its own long-distance affiliate has predictably managed to score above the BellSouth-selected trigger, apparently just avoiding the need to provide a security deposit. It is quite clear therefore that BellSouth seeks to wield the proposed security deposit provisions as an anticompetitive and discriminatory weapon to disadvantage the rivals of its new long distance business. The Commission has repeatedly rejected similar proposals to grant BellSouth and other incumbents wide discretion over payment and security deposit terms for that very reason, and these proposed tariff provisions, like previous attempts, should be rejected.

## II. BELLSOUTH PROVIDES NO EVIDENCE OF ANY CHANGED CONDITIONS THAT WARRANT REVISION OF ITS EXISTING TARIFFS.

As the *Investigation Order* recognizes, BellSouth's proposed tariff revisions "significantly alter" the balance of risk of nonpayment of access charges between BellSouth and its captive access customers. *Investigation Order* ¶ 10. Accordingly, even before addressing the propriety of the specific tariff revisions proposed by BellSouth, the preliminary question to which BellSouth must respond in its direct case is "whether circumstances have changed" in a way that could justify any revision at all in the Commission's longstanding tariff prescription on security deposits. *Id.* BellSouth's direct case on this fundamental issue is virtually non-existent, and its proposed tariff revisions should be rejected on this ground alone.

### A. BellSouth's Bad Debt Risk Has Not Risen Significantly And Certainly Poses No Serious Threat Of Revenue Shortfalls.

BellSouth claims that across-the-board tariff revisions are necessary because "the competitive environment" has changed the business of providing access services into a "high risk, highly volatile industry." BellSouth Direct Case at 2-3; *id.* at 7. But BellSouth provides *no* evidence that its access service business has become more risky, because the reality is quite different.[1] In fact, the excessive and increasing rates of return BellSouth has earned over the last few years confirm that BellSouth retains near-monopoly control over access markets and thus faces little risk of eroding revenues. BellSouth is correct that access reform is needed, but the focus should be on *reducing* the Bell Operating Companies' market power abuses, not increasing their discretion and ability to fleece captive customers. In any event, BellSouth has not remotely demonstrated that its uncollectibles expense – particularly as a ratio of its rapidly increasing access revenues – has risen to significant or even unprecedented levels. To the contrary, BellSouth's uncollectibles expense as a percentage of revenues remains

[1] BellSouth's depiction of its marketplace risk prior to enactment of the Telecommunications Act is equally misleading. For example, in 1989 and 1990, the level of the LECs' projected uncollectibles was expressly contested before the Commission, and several LECs contended that those projections were appropriate, relying for support on many of the very same arguments that BellSouth makes today. Thus, SWBT claimed that its increases in its 1989 uncollectible ratios were appropriate because of the "floundering Texas economy," which, in SWBT's view, "has damaged the financial stability of many I[X]C's," and which, SWBT asserted, means that uncollectibles "can be expected to trend upward." *In the Matter of Annual 1989 Access Tariff Filings*, 4 FCC Rcd. 3638, ¶ 558 (1989). Likewise, Pacific justified its 1990 increase in uncollectibles by claiming that "it forecasts a slowing economy in California and the United States," and by "argu[ing] that this is expected to exert downward pressure on its ability to collect accounts receivable and will increase uncollectibles." *In the Matter of Annual 1990 Access Tariff Filings*, 5 FCC Rcd. 4177, ¶ 387 (1990). In neither instance did these LECs' predictions come true, because the data indicates that the level of LEC uncollectibles remained extremely low in the early 1990s.

remarkably low. BellSouth certainly has not shown that recent fluctuations in uncollectibles expenses are especially volatile or the result of some long-term trend, rather than reflective of general economic business cycles that are endogenous to the price cap regulation of access rates. And BellSouth's claims of crisis arising from the bankruptcy filings of certain carriers is equally exaggerated: excluding its claims relating to Global Crossing and WorldCom bankruptcies – which are unique and non-recurring events precipitated by allegations of massive accounting fraud designed to fool investors and creditors – BellSouth's bankruptcy claims for 2002 are *less* than what it experienced in 2001.

### 1. BellSouth Continues To Reap Exorbitant Returns On Its Access Services.

BellSouth's assertions (Direct Case at 2, 3) that it provides its access services in a "high risk" and "competitive environment" are entirely baseless. To the contrary, despite the market-opening provisions of the Telecommunications Act of 1996, BellSouth and other incumbent LECs continue to be the dominant providers of access services – a position that has allowed them to continue to earn exorbitant – and increasing – returns on those services.

In 2001, a period of time in which BellSouth claims its uncollectibles rose to dangerous levels that it can no longer control with existing tariff provisions that allow it to require security deposits from customers with no or bad track records of payment, BellSouth's own Form 492A demonstrates that it earned a whopping 21.22 percent rate of return on its interstate access services.[2] BellSouth's rates of return on interstate access

[2] BellSouth FCC Form 492A, Rate of Return Report (filed March 30, 2001 & April 8, 2002). In the attached declaration of Bradford Cornell, Professor Cornell reports a similar rate of return (19.41 percent) using BellSouth's ARMIS reports. Cornell Dec.

services were equally bloated in the previous two years: BellSouth reaped a 22.83 percent rate of return in 2000 and an 20.99 percent rate of return in 1999, again despite increases in the absolute amounts of uncollectibles expenses in those years.[3] And, as AT&T recently demonstrated in a petition seeking reform of the regulation of incumbent LECs' special access rates, BellSouth's earnings on special access services are downright shocking.[4] In 2001, for example, BellSouth's own ARMIS reports demonstrate that BellSouth earned just below a *50 percent* rate of return on special access.[5] BellSouth's special access rates of return (like those of every other BOC), moreover, have grown *every year* since 1996 – squarely refuting any claim that these services have become significantly more risky. If the market for access services had in fact become more competitive and risky, then elementary economics dictates that profits would not be so excessive, but would be driven toward costs.[6]

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¶ 15 & Exh. 3 (citing 2001 ARMIS 43-01, Table I, Cost and Revenue Table, Interstate, Column (h), Average Net Investment, Row 1910; 2001 ARMIS 43-01, Table I, Cost and Revenue Table, Interstate, Column (h), Net Return, Row 1915). The slight differences in the reported rates of return are due to the fact that ARMIS reports are filed earlier than the final Form 492 reports. Regardless of the source of the data, it is clear that BellSouth's rates of return on access are excessive.

[3] BellSouth FCC Form 492A, Rate of Return Report (filed March 30, 2001 & April 8, 2002); *cf.* Cornell Dec. ¶ 15 & Exh. 3 (under ARMIS report, rate of return for 2000 was 20.69 percent and for 1999 was 18.34 percent).

[4] AT&T Corp., Petition for Rulemaking, WC Docket 02-___ (filed October 15, 2002).

[5] *Id.* at 8 (BellSouth earned 49.26% in 2001, more than four times the rate of return the Commission found just and reasonable in 1990 – which is itself far too high under current market conditions).

[6] *Id.* at 8-9. Moreover, these rates of return on BellSouth's access services are in fact significantly *understated*, because the costs that BellSouth reports on its ARMIS reports are its embedded costs. *Id.* at 10. BellSouth's true costs of providing access services are the much lower, forward-looking economic costs. *Id.*

BellSouth's pleas that the Commission must immediately intervene to provide BellSouth with additional protections designed to collect even more access revenues simply cannot be reconciled with the marketplace reality that BellSouth's access revenues are already wildly excessive. BellSouth seeks to capitalize on what it calls the "implosion of the telecommunications industry," Direct Case at 3, in its ploy to gain authority to demand hundreds of millions of dollars in "security" from its interLATA competitors, but the evidence is clear that the industry downturn has not had any affect on BellSouth's ability to earn monopoly profits in the provision of access services (and, particularly, special access services).

BellSouth's real world access returns likewise refute any notion that changes in the Commission's longstanding tariff prescription on security deposits are necessary to ensure that BellSouth's deposit requirements are "no different[] than any other commercial entity" in competitive markets.[7] As its exorbitant returns demonstrate, BellSouth is not operating in a competitive environment. As described in Professor Cornell's declaration, in competitive markets, if the customer is not satisfied with the security deposit or other terms that a particular supplier demands, the customer can seek to obtain service from another provider. Cornell Dec. ¶ 24. The customer of a dominant LEC like BellSouth, by contrast, generally has no such choice (*id.* ¶ 25) – which is why the Commission has always recognized the need for prescription in this context that minimizes dominant LEC abuse of security deposit, advance payment and termination

[7] *See* Direct Case at 6-7. As described below, BellSouth's particular tariff revisions on security deposits are *not* in fact like those of companies in competitive industries – companies in competitive industries cannot generally seek to impose more onerous credit terms on customers during an economic downturn. And companies in competitive industries do not demand security deposits from large customers solely based upon the outputs of credit scoring tools, as BellSouth proposes.

requirements. Because BellSouth clearly retains substantial market power in the provision of access services, it retains the incentive and ability to impose unfair and discriminatory terms and conditions, like the security deposit revisions it proposes here – both to increase its own revenues, and, as it increasingly gains section 271 authority, to raise its long distance rivals' costs. *Id.* ¶¶ 7, 25.

### 2. BellSouth's Uncollectibles Are Small Relative To Revenues, And Have Not Varied Substantially Over Time.

BellSouth's proposed tariff revisions are also plainly unsupported because BellSouth has not even shown that it is experiencing any significant or sustained increase in its uncollectibles expenses. BellSouth's claims (¶¶ 19-20) that "there is an increase in uncollectibles after the 1996 Act" are highly misleading. In fact, BellSouth's bad debt levels, like those of other large LECs, remain very small in comparison to revenues. Moreover, the levels of uncollectibles fluctuate from year-to-year, depending on a number of factors including general economic conditions and the particular LEC's efficiency in collecting bad debts. The recent and modest increases in bad debt levels experienced by BellSouth reflect business cycle fluctuations and other temporary events, and not any long-term trend that substantially increases the *future* risks of nonpayment.

The principal data that BellSouth provides in response to the *Investigation Order*'s requests (¶ 11) for BellSouth's uncollectibles levels is a chart that lists the absolute amount of interstate uncollectibles expense from 1990 to 2001. Direct Case at 8, Table 1. Based on this single chart, BellSouth asserts that "there is an increase in uncollectibles after the 1996 Act" and that "the uncollectibles have more than doubled between 1999 and 2000 and again between 2000 and 2001." *Id.* at 9. BellSouth's data, and especially its claims about that data, are highly misleading, for a number of reasons.

Most significantly, BellSouth provides only the absolute amount of interstate uncollectibles, but inexplicably fails to compare those figures to its interstate access revenues, which have increased substantially. The relevant measure of uncollectibles expense is, of course, the *percentage* of revenues that is uncollectible. As shown in the following table, BellSouth's uncollectibles ratios (uncollectibles expense divided by interstate access revenues) are quite small, and have *never* reached 1.5 percent of revenues.

**BellSouth Interstate Uncollectibles Data**
**As A Percentage of Interstate Revenues**
**1990-2001[8] Table 1**

| Year | Interstate Access Uncollectibles (000s) | Interstate Revenues (000s) | Uncollectible Ratio |
|---|---|---|---|
| 1990 | 7,229 | 2,999,148 | **0.24%** |
| 1991 | 8,992 | 2,963,746 | **0.30%** |
| 1992 | 8,541 | 3,017,007 | **0.28%** |
| 1993 | 4,574 | 3,117,192 | **0.15%** |
| 1994 | 12,689 | 3,335,127 | **0.38%** |
| 1995 | 13,472 | 3,343,980 | **0.40%** |
| 1996 | 28,405 | 3,426,741 | **0.83%** |
| 1997 | 38,295 | 3,652,930 | **1.05%** |
| 1998 | 16,628 | 3,906,007 | **0.43%** |
| 1999 | 14,361 | 4,045,767 | **0.35%** |
| 2000 | 31,189 | 4,236,311 | **0.74%** |
| 2001 | 67,982 | 4,659,286 | **1.46%** |

As these figures confirm, BellSouth is not suffering from any bad debt "crisis." Its level of uncollectibles is low by virtually any measure, and even the modest increases in the years 2000 and 2001 still have not placed any substantial percentage of BellSouth access revenues in jeopardy. And, as described above, these recent slight increases in bad debt have still had no cognizable negative impact on BellSouth's ability to earn just and

[8] 1990-2001 ARMIS, 43-01, Table 1, Cost and Revenue Table, Interstate, Row 1060, Uncollectibles; 1990-2001; ARMIS, 43-01, Table 1, Cost and Revenue Table, Interstate, Row 1090, Total Operating Revenues.

reasonable returns – indeed, BellSouth continues to reap exorbitant rates of return on its access services.

Nor can the mere fact that there have been fluctuations in the year-to-year levels of uncollectibles expense justify any tariff revisions. BellSouth's uncollectibles expenses have always fluctuated over time. As Professor Cornell explains (¶¶ 9, 16), this is entirely normal and the result of a variety of factors, such as general economic conditions or BellSouth's efficiency at collecting its debts, and, as explained below, it was anticipated by and accounted for in establishing price caps. Thus, as shown in Table 1, in 1996 and in 1997, BellSouth experienced increases in its uncollectibles ratios, from 0.40 percent in 1995, to 0.83 percent in 1996, and then to 1.05 percent in 1997. However, in 1998 and again in 1999, BellSouth's uncollectibles ratio declined, back down to 0.43 percent in 1998 and to 0.35 percent in 1999. As these figures demonstrate, there is no valid basis for BellSouth's claims that "there is an increase in uncollectibles after the 1996 Act." Rather, the uncollectibles ratios have fluctuated over time. As Professor Cornell explains, the 2000 and 2001 fluctuations are not significantly different than prior fluctuations and could not support any reasoned conclusion that there is a long-term trend of increased uncollectibles expense.[9]

[9] Cornell Dec. ¶ 9. It is also significant, as discussed Professor Cornell's declaration, that BellSouth has the highest uncollectibles ratio of any large LEC. Cornell Dec. ¶¶ 10-11 & Exh. 2. Although that higher level could be caused by some regional variation, it may indicate that BellSouth is somehow less efficient at collecting its bad debts, or in correctly implementing the current tariff provisions allowing it to require security deposits. *Id.* ¶ 11. One of the fundamental objectives of the Commission's LEC price cap regime is to insulate access ratepayers from being required to fund such inefficiencies in those carriers' operations.

Beyond these errors, even the absolute figures on interstate uncollectibles that BellSouth presents are misleadingly high.[10] Those figures include bad debt for access services attributable to end users, which is plainly not relevant to the security deposits BellSouth is seeking to impose on carrier customers. From BellSouth's ARMIS reports, it is not possible to determine precisely the amount of end user uncollectibles compared to uncollectibles caused by wholesale customers. However, if end user customers default at approximately the same rate as carrier customers (and, excluding aberrations like MCI WorldCom, end user customer default rates may well be higher), it is clear that BellSouth's absolute figures on interstate uncollectibles vastly overstate the amount of wholesale customers' uncollectibles. In the year 2001, for example, BellSouth claims that its interstate access uncollectibles were about $67 million. But if end user customer default rates are approximately the same as carrier default rates, about $27 million of that is attributable to end users, and only the remaining $40 million is attributable to wholesale customers.

BellSouth also points to the amounts of the claims that it has asserted in bankruptcy proceedings since 2000 as evidence that its risks of nonpayments have greatly increased in recent years.[11] Those figures are both seriously flawed and ultimately not

[10] BellSouth also makes vague and unsupported claims that its "total" uncollectibles for 2001 and 2002 exceeded $300 million. Direct Case at 8-9. Again, BellSouth fails to provide the relevant information on its revenue that is necessary to judge properly any trend in bad debt expense. Moreover, and in all events, those total uncollectibles include all types of bad debts that bear no relation whatsoever to the issues in this proceeding about the propriety of demanding millions of dollars of security deposits from access customers. For example, uncollectibles relating to interconnection agreements (*see id.* at 9 n.10) would likely involve payments for unbundled network elements, issues which go well beyond the interstate access services at issue here.

[11] Direct Case at Exhibit 2.

indicative of the risks of nonpayment at which security deposit provisions are targeted. First, as BellSouth concedes (Direct Case at 10 n.11), many of these bankruptcy proceedings remain open, and BellSouth cannot determine (or will not reveal) the amounts that it has or will recover from the bankrupt entities. Thus, the amounts of the claims presented by BellSouth significantly overstate actual uncollectibles.[12] Second, the amounts of the claims presumably include the value of *all* of the services that BellSouth provided to these carriers, and not merely access services – which again results in a significant overstatement of the relevant uncollectibles expense. Third, and most significant, the amounts claimed for 2000 and 2001 are quite small – only the claims for 2002 are significant, totaling to about $150 million. But virtually all of that total – $138 million, or about 92 percent – relates to bankruptcies filed by MCI WorldCom and Global Crossing. And those bankruptcies have been linked to massive and unprecedented instances of accounting improprieties. It would obviously be improper to base future policy that will affect all customers on such aberrations that are both unlikely to be repeated (given the serious tightening of accounting and related regulation by the Securities and Exchange Commission and other regulators) and not redressible through security deposit provisions (which BellSouth concedes must rely upon what is reported

[12] And in fact, by virtue of its status as a dominant supplier of access, BellSouth has a superior position that makes it more likely to obtain recovery of its claims in bankruptcy. A bankrupt entity's executory contracts can be assumed and assigned pursuant to 11 U.S.C. §§ 365(b)(1) and (f)(1) if the debt associated with such contracts is cured, or paid. Because the LECs' access services are typically the only option available, a company emerging from bankruptcy or a company acquiring all or part of a bankrupt entity will often seek to assume the existing LEC access services. In that instance, as a condition for the assumption and assignment of the access services, the bankruptcy code provides for payment of both the pre-petition and post-petition claims. Thus, there is no basis to presume that BellSouth will not ultimately obtain payment for significant amounts it has claimed in bankruptcy proceedings.

and cannot account for what is hidden or misrepresented).[13] With those two claims removed, BellSouth's bankruptcy claims for the first 10 months of 2002 are only about *half* the 2001 levels.

The *Investigation Order* seeks to determine whether BellSouth can demand security deposits from remaining *viable* carriers. If anything, the downfall of MCI WorldCom and others should strengthen the remaining viable carriers who will inherit additional customers. Moreover, as described in the Professor Cornell's declaration, the bankruptcy data presented by BellSouth tends to show that bad debt expense for the listed companies will generally *not* be occurring in the future. Cornell Dec. ¶¶ 13-14. In short, BellSouth has not come close to meeting its burden of demonstrating that an overhaul of longstanding security deposit provisions is necessary to protect it from extraordinary and nontransitory increases in the risk of nonpayment by carrier customers for access services.

### B. BellSouth's Existing Price Cap Rates Adequately Compensate It For The Risk of Uncollectibles.

Any expansion of BellSouth's security deposit tariff provisions is both unnecessary and improper because the Commission's price cap regime already accounts for uncollectibles expense – and fluctuations in the levels of uncollectibles expenses – in the rates that BellSouth may charge access customers. As the *Investigation Order*

[13] Where a company engages in serious accounting fraud that is designed to mask its true financial state, the reported information relied upon by credit managers would likely show that no unusual credit terms or security deposits are needed. In this regard, it is significant to note that BellSouth and the other large incumbent LECs are among the many suppliers (including AT&T) that have large claims against the MCI WorldCom estate. The tariff revisions that BellSouth and other incumbent LECs seek would likely not provide additional security in cases where companies engage in fraud or other improper practices.

recognizes (¶¶ 3, 11), BellSouth is a price cap carrier, and any year-to-year fluctuation in uncollectibles will either reduce or increase BellSouth's profits, but, under the design of the price cap system, such fluctuations cannot entitle BellSouth to assess higher rates. And by the same token, BellSouth cannot circumvent this feature of price caps by adopting what is in effect a massive rate increase through new security deposit tariff provisions that would radically alter the balance of risk as between BellSouth and its captive access customers.

The *Investigation Order* specifically directed that "[a]s part of its direct case, BellSouth shall explain why it believes its rates under price caps do not adequately compensate it for the risk of uncollectibles."[14] As the *Investigation Order* explained, "BellSouth's rates include a revenue requirement component for uncollectible debts that is based on the amount of uncollectibles permitted as an interstate revenue requirement at the time BellSouth became subject to price cap regulation."[15] The *Investigation Order* directed BellSouth to submit data as to the "level of uncollectibles that was included in its initial price cap rates," and then to "address whether the variation in uncollectible levels for 2000 and 2001 is merely a normal fluctuation in uncollectibles, which would be covered by the business risks expected to be endogenous to price caps, or whether it reflects some long term trend that warrants expanded security deposits."[16] In addition, the *Investigation Order* required BellSouth to "address what modifications should be made to its price cap indexes and service band indexes to account for the changes to the

[14] *Investigation Order* ¶ 11.

[15] *Id.*

[16] *Id.*

capital and risk parameters of price caps" that would occur if the Commission were to permit changes to BellSouth's access tariff to include expanded security deposit discretion.[17]

BellSouth's Direct Case provides no serious response to the *Investigation Order's* inquiries. BellSouth provided only some of the data requested in the *Order*, but did not even attempt a detailed explanation as to why it believes its rates under price caps do not adequately compensate it for the risk of uncollectibles.[18] Rather, pointing to its misleading claims that its uncollectibles rose after the passage of the 1996 Act, BellSouth asserts, again without citation or other support, that "[t]he circumstances can hardly be characterized as reflective of normal business risks that are endogenous to price caps."[19] That *ipse dixit* is not a reasoned response to the Commission's inquiry.

In fact, any fluctuations in the year-to-year level of uncollectibles are simply "business risks" that are endogenous to the price cap regime.[20] Actual levels of uncollectibles expenses – like actual levels of *all* expenses – will vary over time, depending upon factors such as general economic conditions and the LECs' own efficiency in collecting bad debts. In years where economic conditions are poor, and

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[17] *Id.*

[18] In a footnote, BellSouth claims – without any citation or support from a sworn declaration – that "it was determined that the initial price cap rates only reflected an uncollectibles amount of $2,196,000, or about one quarter of the amount that would have been included based on actual uncollectibles during the period from July, 1990 through June, 1991." Direct Case at 8 n.9. Even if that is true, BellSouth fails to explain how its current efforts to effectively increase that revenue requirement should be permitted because it failed to include about three-quarters of the amount permitted by the Commission in 1990, when it put price caps in place.

[19] Direct Case at 9.

[20] *Investigation Order* ¶ 11.

where uncollectibles in fact rise, a LECs' profits, all other things being equal, will be reduced. On the other hand, when economic conditions improve and where uncollectibles fall, a LECs' profits can be expected to be greater.[21] The very purpose of the price cap regime is to hold rates and other terms constant in the face of expense fluctuations to increase the LEC's incentives to act efficiently.

As the *Investigation Order* recognizes (¶ 3), under the price cap regime, a LEC experiencing a rise in uncollectibles must demonstrate either that the increase is due to a change in exogenous costs, *i.e.*, some "administrative, legislative or judicial action beyond the control of the carriers,"[22] or that their earnings are low enough to justify an above-cap filing.[23] As it admits,[24] BellSouth has not sought an exogenous cost change, and it also has not even attempted to demonstrate that recent fluctuations in uncollectibles expense have been so extreme that existing rates and tariff provisions will prevent it from earning a just and reasonable return – a showing that it could not make given its exorbitant returns.[25]

[21] In a number of years since price caps were instituted in 1990, BellSouth and a number of LECs experienced very low uncollectible rates because of economic and other conditions. Their profits in those years were likely larger because they had very little bad debt. However, BellSouth and the other incumbent LECs have never come forward at those times to relax credit terms to make them more favorable to customers.

[22] *In the Matter of Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd. 6786, ¶ 166 (1990).

[23] *Investigation Order* ¶ 3.

[24] Direct Case at 9.

[25] In fact, granting BellSouth relief here would provide a graphic illustration of why price caps do not eliminate the incumbent LECs' incentives to reduce costs. The incumbents would be secure in the knowledge that, despite the price cap system, they can request regulatory relief to obtain higher rates (or their equivalent – such as the increased security deposits at issue here) in circumstances where the strict application of price caps would reduce their earnings.

Given the price cap regime, the *Investigation Order* required BellSouth to demonstrate, at a minimum, that any changes in its uncollectibles constitute a long-term trend, rather than a simple change in the business cycle or a reduction in its own efficiency in collecting bad debts.[26] BellSouth has not made that showing. As described above, BellSouth's uncollectibles expense has fluctuated over time, and even since 1996, has first increased, then decreased, and then increased again – variability that is entirely consistent with business cycles and other short-lived events.[27] Moreover, the very difficulties in the telecommunications industry over the past few years that BellSouth claims require relief will help reduce the risk of bad debt expense going forward. As Professor Cornell describes, given the capital market conditions, few new firms (and even fewer financially unstable firms) will be entering telecommunications markets. Cornell Dec. ¶ 14. And the firms that have declared bankruptcy – which are more likely the ones that made the "questionable business decisions" about which BellSouth claims[28] – will either cease to exist or will emerge from bankruptcy with little or no debt and thus will not present extraordinary future risk of non-payment. Cornell Dec. ¶¶ 13-14. Thus, as in the past, BellSouth's level of uncollectibles expense ratio will almost certainly continue to ebb and flow, but cannot be expected, on average, to rise materially.

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[26] *Investigation Order* ¶¶ 3, 11, 14

[27] As Professor Cornell explains, the increases in BellSouth's uncollectibles percentage from 1990 through 1997 have also been followed at some point by decreases in the uncollectibles percentage. Cornell Dec. ¶ 9. If in 1998 BellSouth had used its more than six-fold increase in percentage uncollectibles between 1993 and 1997 to argue that its uncollectible receivables had increased permanently as a percentage of revenues, it would have been wrong. *Id.* By the same token, recent fluctuations are more than likely caused by normal changes in the business cycle or other short-term circumstances. *Id.*

[28] Direct Case at 7.

The only fact that BellSouth points to as evidence of any long-term trend or change in its uncollectibles is its repeated claims that the Telecommunications Act of 1996 changed the economic environment in which it provides access services from a rate-of-return environment to one governed by competitive market forces.[29] However, nothing in the Act necessarily makes it more likely that BellSouth and other incumbent LECs will have higher levels of bad debt. The Act did not change the regulation of access services through the price cap system, which means that today, as in the years prior to the Act, BellSouth is properly compensated for the risk of uncollectibles. And the Act – which was designed largely to open *local* markets to competition – did not create any change in the risks of nonpayment by access purchasers. The long distance industry has been subject to intense competition for many years, and well before the passage of the Act.

In all events, even if BellSouth could show that some long-term trend had occurred that changed the degree of its risk of nonpayment, and thus justified additional security deposits, BellSouth entirely fails to address the request in the *Investigation Order* (¶ 11) that it "address modifications" to its price caps to account for the decreased payment risks that would accompany the increased security deposits. If the Commission were to adopt any change to the tariff provisions regarding security deposits, that change (along with the fact that BellSouth is already earning exorbitant returns) would demand that the Commission also reduce BellSouth's price caps.

For all these reasons, the price cap regime ensures that BellSouth and other LECs are already properly compensated for the risk of uncollectibles.

[29] Direct Case at 2-3, 7, 11.

### C. BellSouth Is Adequately Protected By The Commission's Longstanding Prescription Allowing Security Deposits From Customers With Unusual Risks of Non-Payment.

BellSouth's existing tariffs contain longstanding, Commission-prescribed language that allows BellSouth and other incumbent LECs to collect security deposits from customers with a poor payment history or with no established credit.[30] Those provisions have protected BellSouth and other incumbent LECs for over 15 years – in both good and bad economic times – and they remain more than sufficient today. In fact, BellSouth admits that fully 5.5 percent of its monthly intrastate and interstate access revenues are *presently* secured by deposits.[31] Given that the level of its interstate uncollectibles was less than 1.5 percent in 2001 (and, in most years, is less than 1 percent), there is no conceivable need to allow BellSouth the flexibility to secure even more of its revenues with deposits.

Moreover, in response to the *Investigation Order*'s request (¶ 13) to address "the percentage of interstate billings that are billed in advance" and how that percentage affects the risk faced by BellSouth, BellSouth has revealed that fully 89 percent of its access services that are billed via the Carrier Access Billing System are already billed in advance[32] – which, as Professor Cornell explains, provides a built-in one month security deposit. Cornell Dec. ¶ 28. Because the overwhelming percentage of BellSouth's access services billed via CABS are billed in advance, the amount at risk due to nonpayment is

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[30] *See* Memorandum Opinion & Order, *Investigation of Access and Divestiture Related Tariffs*, 97 F.C.C.2d 1082, 1168-70 (1984) ("*1984 Access Order*").

[31] Direct Case at 8 n.*.

[32] Direct Case, Exhibit 2.

small – a further reason why there is no need to change the existing security deposit prescription.

The unfortunate reality is that BellSouth's proposed tariff changes are not aimed at deadbeat or bankrupt customers, but rather at healthy customers – which also happen to be BellSouth's competitors. And therein lies a fatal flaw in BellSouth's claims – it has not even attempted to show that radical changes to the Commission's prescribed tariff language are required to protect it from the possibility that its credit worthy customers will not pay, or that those customers are not likely to pay their bills in the future.

BellSouth contends that its tariff revisions would allow it to "implement credit practices that are prevalent throughout American industry."[33] However, as Professor Cornell explains, the critical distinction here is that credit practices in other industries (and in other markets in the telecommunications industry) are disciplined by market forces, whereas BellSouth's dominance in providing access leaves its customers with no realistic alternatives from which to choose. Cornell Dec. ¶¶ 24-25. Thus, in other industries, if a company demands a substantial security deposit from a large customer, the company risks losing the customer to another supplier who determines to offer better credit conditions. *Id.* That marketplace dynamic provides a powerful incentive for companies to evaluate properly a customer's true creditworthiness, and not to request security deposits unless the harm from a default and the risk of default outweigh the potential revenues. *Id.* For BellSouth, in contrast, there are rarely any market forces that discipline its credit decisions, and thus BellSouth has every incentive to abuse its authority to demand security deposits. *Id.*

[33] Direct Case at 1, 6-7.

BellSouth's reaction to its modest recent increases in uncollectibles is also not at all prevalent in other industries. Rather, when the customers of companies in competitive industries uniformly experience hard times, those competitive companies themselves often suffer as well – and they certainly are *not* able to request relief from a regulatory agency to avoid slight increases in bad debt expense. In its request to change its credit practices in response to a downturn in the business cycle, therefore, BellSouth seeks not equal treatment, but special treatment to which it is not entitled and that would seriously harm competition and consumers.

## III. THE SPECIFIC REVISIONS THAT BELLSOUTH PROPOSES ARE UNLAWFULLY VAGUE AND WOULD PROVIDE BELLSOUTH WITH UNFETTERED DISCRETION TO DEMAND SECURITY DEPOSITS FROM ITS COMPETITORS.

### A. BellSouth Has Not Demonstrated That Its Proposed Security Deposit Triggers Are Sufficiently Correlated With Non-Payment Risks.

The Act requires that a tariff be "just and reasonable," and not "unreasonab[ly] discriminat[ory]," and the Commission's rules further mandate that tariff provisions " contain clear and explicit" statements in order "to remove all doubt" as to the proper application of the tariff.[34] BellSouth's initial tariff filing plainly violated all of these criteria. As explained by the *Investigation Order*, BellSouth's initial tariff filing raised serious "concerns about whether the tariff language clearly and unambiguously sets forth a standard that can be objectively administered in a nondiscriminatory manner."[35] BellSouth likewise "has not shown that [BellSouth's new criteria for demanding a security deposit] . . . are valid predictors of the likelihood of a customer paying its access bill, or that they are better predictors of whether a customer will pay its bills in the future

[34] *See* 47 U.S.C. §§ 201, 202; 47 C.F.R. § 61.2.

that the customer's past payment history."[36] Accordingly, the Commission ordered BellSouth to "explain how [each of BellSouth's proposed criteria] . . . is a valid predictor of whether the carrier will pay its interstate access bill"[37] and "how such varied data can be applied in a manner that will not produce arbitrary and/or discriminatory results."[38] The Commission emphasized that a satisfactory response to these critical issues "is especially important here because in most cases the entity upon which BellSouth would impose the security deposit would also be a competitor of BellSouth itself, or of its long-distance affiliate."[39]

BellSouth's Direct Case barely addresses these serious concerns. In fact, the only real difference between BellSouth's initial tariff filing, and the information provided in BellSouth's Direct Case is that BellSouth's Direct Case identifies two specific credit scoring tools that BellSouth proposes to use to evaluate whether particular carriers should be subject to deposit requirements. BellSouth asserts that it will largely rely on "two commercially available credit scoring tools" – the Risk Assessment Manager ("RAM") and RiskCalc – to determine whether a carrier will be subject to substantial new deposit requirements.[40] BellSouth explains that these credit scoring tools are designed to assess a credit score between one and ten, where one is bad and ten is good. BellSouth proposes

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[35] *Investigation Order* ¶ 10.

[36] *Id.* ¶ 15.

[37] *Id.*

[38] *Id.*

[39] *Id.*

[40] BellSouth Direct Case ¶ 25.

that any carrier that receives a credit score below five be subject to a large deposit requirement – and, even then, it reserves the right also to demand deposits from customers scoring above five.

BellSouth does not, however, provide any additional evidence to show that these models can accurately predict a carrier's ability to pay its access bills in the future, or that those credit scoring tools are better predictors of a carrier's ability to pay its access bills than the carrier's prior payment history. And BellSouth nowhere provides evidence demonstrating that it is appropriate to use the two credit scoring tools in the manner that BellSouth proposes – and, indeed, it is not. BellSouth also fails to address the Commission's concern that BellSouth's tariff is ambiguous and highly subjective.

Thus, there is no question that BellSouth's amended tariff proposal suffers from the same problems as its initial tariff filing. BellSouth's amended tariff proposal does not remotely "remove all doubt" as to the proper application of its tariff, and creates the opportunity and incentive for BellSouth to "discriminate" against its competitors.[41] On the contrary, under BellSouth's proposal, BellSouth would retain *complete control* over whether *any* particular carrier would be subject to substantial deposit requirements. BellSouth does not even attempt to hide this fact. According to BellSouth, its "credit specialists [will] take into account current information that might negate good scores" and "such information would override the model scores."[42] Thus, under BellSouth's proposal, BellSouth can collect large deposits from *any* carrier, regardless of that carrier's credit score or payment history.

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[41] *See* 47 U.S.C. §§ 201, 202; 47 C.F.R. § 61.2.

[42] BellSouth Direct Case ¶ 31.

Even if BellSouth had not expressly reserved unilateral authority to impose deposit requirements on carriers that pass its RAM and RiskCalc hurdles, BellSouth still would effectively control the credit scores produced by the credit scoring tools. The credit score tools proposed by BellSouth are very complex and require substantial user input and customization. As explained in the attached declaration of Raymond Blatz, AT&T recently contacted a Dun & Bradstreet representative to obtain sample runs of the RAM model to determine the accuracy of BellSouth's purported credit scores for BellSouth Corporation and for BellSouth Long Distance Company. Blatz Dec. ¶ 10. That representative emphasized to Mr. Blatz that Dun & Bradstreet would not likely be able to replicate BellSouth's results, because every user of the RAM credit scoring tools, including BellSouth, has the ability to (and indeed must) customize the inputs and weighting factors used in the RAM credit scoring tool. *Id.*

Indeed, the Dun & Bradstreet representative explained that there are myriad ways in which the RAM credit scoring model can, and in some cases must, be customized by the user. RAM users must identify the inputs on which the model will produce credit scores. *Id.* ¶ 11. Those inputs can be based on a variety of different types of data, including, internal data, data obtained from third parties, and data provided by Dun & Bradstreet. *Id.* RAM users also must set several weighting factors that determine how much weight is placed on various inputs. *Id.* As one example, a RAM user can set a high weighting factor for the inputs that denote prior defaults on payments to creditors. *Id.* In so doing, the credit score will be more affected by prior payment defaults than it would if the weighting for that input were set at a lower level. *Id.*

On these facts, there can be no legitimate debate that BellSouth can substantially affect a carrier's RAM credit score by varying the inputs and the weighting factors. This fact is starkly illustrated by a comparison of the RAM credit scores that BellSouth has produced for itself and its long-distance affiliate with the RAM credit scores based on BellSouth's inputs and weighting factors to the RAM credit scores produced, at AT&T's request, for those same companies by a Dun & Bradstreet representative. BellSouth's version of the RAM credit scoring tools produced RAM credit scores from BellSouth Corporation and BellSouth Long Distance of 5.3 and 5.9, respectively.[43] By contrast, the RAM credit score produced by the Dun & Bradstreet representative – using different set of inputs and weighting factors[44] – produced scores for the same companies of 1.5 and .86, respectively. Blatz Dec. ¶ 12. Thus, there is no question that the RAM credit scoring tools can produce vastly different results, depending on how the user customizes the inputs and weighting assumptions.

Allowing BellSouth to base deposit decisions on the credit scores produced by the RAM and RiskCalc (which likewise is customizable) credit scoring tools, therefore, would effectively provide BellSouth with virtually unfettered ability (and incentive) to manipulate credit scores by varying the inputs and weightings used by the models. *See*

[43] These scores themselves indicate that there is a serious problem with the inputs and weightings used by BellSouth. According to BellSouth's calculations, the credit scoring tools actually produce a *lower* credit score for BellSouth Corporation – a monopoly carrier with a virtually guaranteed income stream – than it does from BellSouth's long-distance affiliate – a new company that operates in a highly competitive environment. As Professor Cornell explains, these results are exactly the opposite of that what would be expected. *See* Cornell Dec. ¶¶ 21-22.

[44] The Dun & Bradstreet representative explained that there are no "generic" inputs or weighting factors. The RAM scoring tool used by the Dun & Bradstreet representative is based on the inputs used by Dun & Bradstreet to demonstrate how the RAM credit scoring model works.

Cornell Dec. ¶¶ 17-18, 23-24. Tellingly, BellSouth has not even bothered to inform the Commission of this fact, nor has BellSouth made the inputs and weightings it has used in estimating its own score available for the Commission and interested parties to inspect.

Moreover, BellSouth has chosen a completely arbitrary threshold credit score that triggers deposit requirements. According to BellSouth, any carrier that receives a credit score of five or lower from *either* credit scoring tool (the RAM credit scoring tool or the RiskCalc credit scoring tool) automatically will be subject to BellSouth's deposit requirements, and carriers that receive a credit score of above five from both credit score tools will not be subject to a deposit (unless, as noted above, BellSouth unilaterally determines that such a carrier should be subject to a deposit requirement notwithstanding a good credit score).[45] Thus, for example, a carrier with a perfect payment history that receives a perfect credit score of ten from the RiskCalc scoring tool, but receives a score of credit score of 4.99 from the RAM credit scoring tool (based on BellSouth's unknown customizations) automatically would be subject to potentially hundreds of millions of dollars in deposit requirements. BellSouth offers no legitimate support for this credit score threshold, stating only that "BellSouth's experience has been that customers who score at least a five in both models are sufficiently creditworthy so as not to require a deposit."[46] This assertion cannot be given any weight, because it is not documented or supported by any evidence in the record.

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[45] BellSouth Direct Case ¶ 31.

[46] BellSouth Direct Case ¶ 31.

### B. BellSouth's Proposed Tariff Revisions Would Provide It With Enormous Discretion In Requiring Security Deposits, Which It Could, And Would, Use To Discriminate Against Competitors.

The combination of an arbitrary deposit threshold credit score and BellSouth's ability to manipulate credit scores by changing the inputs to the credit score tools (and, if necessary, overrule any "passing" score) creates unbounded discretion for BellSouth to saddle any carrier with massive deposit requirements. As a result, neither the Commission nor interested parties can, based on the record in this proceeding, predict which carriers will be subject to such deposit requirements. BellSouth's tariff is therefore unlawfully vague, and because BellSouth could use – and has a substantial incentive to use – that unbounded discretion to impose large costs on its competitors, BellSouth's tariffs also are unlawfully discriminatory.

This is especially troubling, "because in most cases the entity upon which BellSouth would impose the security deposit would also be a competitor of BellSouth itself, or of its long-distance affiliate."[47] Absent sufficient safeguards, BellSouth could, for example, rely on tariffs to demand that IXCs provide substantial security deposits, but then determine, that BellSouth's long distance affiliates are sufficiently creditworthy to be excused from such a requirement. Indeed, BellSouth has apparently already determined that its new long distance affiliate is sufficiently creditworthy that no deposit would be required. *See* Cornell Dec. ¶¶ 20-25.

Moreover, even if BellSouth required its affiliate to post a deposit – in an amount similar to those posted by competing IXCs – there would still be little hardship on BellSouth, because such a deposit would constitute a classic "left-pocket, right-pocket"

[47] *Investigation Order* ¶ 15.

transfer that inflicts no real costs on the BellSouth entity as a whole. In both cases, the unfettered right to demand a security deposit from any IXC would, as the Commission recognized in 1984, be a powerful anti-competitive and discriminatory weapon.[48] To prevent BellSouth from obtaining this addition method of harming interLATA competition, it is critical that BellSouth be precluded from arbitrarily assessing large deposits on its competitors.

BellSouth incorrectly suggests that the Commission can look past these fatal flaws in its tariff because firms in competitive industries sometimes use the same credit tools to assess credit risk of potential creditors. As explained in the Mr. Blatz's declaration, firms generally do not use either or both of the models proposed by BellSouth as the *sole* means for assessing credit risk.[49] Nor do competitive firms typically set arbitrary credit score thresholds (as BellSouth has done) to determine whether large commercial customers will be subject to deposit requirements. Rather, competitive firms, including AT&T, use credit scores as one among many factors, and not as a bright-line test. Even the documentation of one of the credit scoring tools that BellSouth proposes to rely upon emphasizes that the tools are not designed to be the sole determinant for assessing creditworthiness:

> Like all new technologies, RiskCalc is a supplement to, not a substitute for, good judgment. Many factors not reflected in balance sheets and income statements are relevant to gauging loan risk. The score produced by RiskCalc alone cannot answer the deeper question as to whether the credit

[48] *See 1984 Access Order*, 97 F.C.C.2d at 1168-70 (LEC proposals to expand security deposit provisions were "unreasonably onerous" in scope and had "anticompetitive effects" where proposals applied so broadly and could be applied selectively to carriers chosen unilaterally by the LEC).

[49] Blatz Decl. ¶¶ 5-8.

> adds value from a portfolio relationship perspective. However, what RiskCalc can do is efficiently summarize on portion of the problem (financial statements) so that an analyst can focus her expertise more productively.[50]

In all events, even if BellSouth's proposals were consistent with the practices of firms in competitive industries (which they are not), that would not mean that BellSouth, a monopoly firm, should be permitted to implement them. As descried above and in Professor's Cornell's Declaration, firms in competitive markets have substantial incentives accurately to ascertain credit risk, and to impose deposit requirements only where a substantial credit risks actually exists. A competitive firm that attempts to impose large deposit requirements on a customer that is not likely to default on future payments will lose the business of that customer to competitors that do not impose such unnecessary deposits requirements.

BellSouth, however, faces none of those competitive pressures – BellSouth is a near monopoly that does not face any serious risk of losing a substantial number of access customers as a result of imposing unnecessary deposit requirements on those customers. Because BellSouth does not face any measurable competitive pressures, it has every incentive to minimize *any* risk of non-payment by maximizing deposits. BellSouth also has incentive to favor its own affiliates that do operate in competitive markets by imposing large deposit requirements on companies that pose the greatest threat to those affiliates. And that is precisely why BellSouth is seeking regulatory approval to impose deposit requirements based on scoring tools that are easily manipulated by BellSouth.

The bottom line is this: BellSouth's tariff provides BellSouth with unbounded discretion to impose hundreds of millions of dollars of deposit requirements on its

[50] BellSouth Direct Case, Exhibit 3 at 4.

customers. Such unbounded discretion is unlawful because it violates the Commission's rule that a tariff "must contain clear and explicit" statements in order "to remove all doubt" as to the proper application of the tariff and because it is unreasonably discriminatory in violation of the Act.[51] Accordingly, BellSouth's tariff must be rejected.

## IV. BELLSOUTH'S PROPOSED ARBITRATION PROVISIONS ARE UNREASONABLE.

The provisions in BellSouth's proposed tariff regarding the arbitration of disputes over the security deposit are also unlawfully vague, unreasonable, and should be rejected. The tariff states, for example, that "BellSouth and Customer *shall* then jointly request commercial arbitration." *See also* Direct Case at 16 (referring to the "requirement" of dispute resolution). However, the tariff also states that it "is not intended to require waiver of right to pursue legal recourse in a court of law or at the FCC." At the very least, the tariff is unlawfully vague on this point, and should be clarified to state that customers need not arbitrate but may seek remedies in court or at the Commission.

To the extent the tariff is intended to *require* arbitration for all disputes regarding the propriety and amount of a security deposit, that requirement is improper, particularly in light of BellSouth's status as the dominant provider. The issues regarding the propriety and amount of a deposit would often raise important policy questions that may best be resolved by the Commission, and then subject to review in federal court, rather than by determination through an arbitrator. This is particularly true in light of the fact that the amount of the security deposit could be hundreds of millions of dollars, and, as the *Investigation Order* recognizes, could have a severe impact not only on the customer, but on competition generally in telecommunications markets. The typically narrow scope

[51] *See* 47 C.F.R. § 61.2; 47 U.S.C. §§ 201, 202.

of review of an arbitrator's decision would mean that the Commission may not have a full opportunity to address these and other issues that lie squarely at the heart of its jurisdiction. In this regard, the dispute resolution procedures in the proposed tariff revisions are all the more critical because access customers – unlike the customers of the suppliers in competitive industries that BellSouth purports to emulate – have no ability to choose an alternative supplier in the event of a security deposit request. Limiting these customers' sole recourse to an expedited arbitration with limited procedural rights is simply unfair and unreasonable.[52]

In addition, there is no basis to require that the losing party pay all the costs of the arbitration, rather than requiring the parties to split the costs of the arbitration (or to allow the arbitrator to decide the issue of costs, as the AAA rules provide (*see* Direct Case at 20)). As the *Investigation Order* concludes, BellSouth's proposal would "significantly alter" the balance between BellSouth and the customer.[53] BellSouth is apparently afraid that, without such a "loser pays" requirement, customers may bring arbitrations that are not legitimate. However, if that were to occur, it would be caused less by such arbitration cost provisions and more by the gigantic costs that BellSouth's security deposit provisions would wreak on its access customers. The costs of such deposits would typically far outweigh the costs of the arbitration, and, if faced with a deposit requirement

[52] In this regard, AT&T's service agreements with many of its customers (including even smaller end users) contain arbitration provisions that also allow the customer to opt out of arbitration and raise claims in small claims court. *See, e.g.*, *Boomer* v. *AT&T Corp.*, 2002 WL 31202126 (7th Cir. Oct. 3, 2002). In addition, AT&T pays the costs of the arbitration. *Id.*

[53] *Investigation Order* ¶ 25.

of tens or hundreds of millions of dollars, most customers would rationally choose to arbitrate the dispute regardless of the existence of any "loser pays" provisions.

## V. CONCLUSION

For the foregoing reasons, the Commission should find that BellSouth's Transmittal No. 657 is unjust, unreasonable, and discriminatory. Accordingly, the Commission should reject the proposed tariff revisions.

Respectfully submitted,

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October 24, 2002.

## CERTIFICATE OF SERVICE

I hereby certify that on this 24th day of October, 2002, I caused true and correct copies of the forgoing Comments of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: October 24, 2002
Washington, D.C.

/s/ Peter M. Andros
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